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CHARLES ELMORE

In the

Supreme Court of the United States.

October Term, 1934.

No. 12.

Guy T. Helvering, Commissioner of Internal Revenue,

Petitioner,

v.

Morgan's, Incorporated, et al.

RESPONDENTS' BRIEF.

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MORGAN'S, INCORPORATED, et al.

RESPONDENTS' BRIEF.

Concise Statement of the Case.

Morgan's, Incorporated, the parent, on June 1, 1925, acquired the entire capital stock of Haines Furniture Company, the subsidiary, and the two companies, both Massachusetts corporations maintaining books on a calendar year basis, were affiliated from then to the end of 1927. (The two corporations are still affiliated.)

Haines Furniture Company filed a separate return for the period January 1, 1925, to May 31, 1925, disclosing its net loss of $59,239.56; its net loss for the balance of the calendar year 1925 of $61,626.69 was included in the consolidated corporation income tax return filed by Haines

Furniture Company and Morgan's, Incorporated, for the calendar year 1925. For 1926 the net loss of $2551.76 of Haines Furniture Company was included in the consolidated corporation income tax return filed by Haines Furniture Company and Morgan's, Incorporated. In the consolidated corporation income tax return filed by the same companies for the calendar year 1927, the income of Haines Furniture Company of $63,188.34 was reduced by the net loss sustained by that company for the period January 1, 1925, to May 31, 1925, of $59,239.56. The Commissioner refused to allow this deduction and assessed a deficiency against each company. No part of the net loss sustained by Haines Furniture Company for the part of the year 1925 prior to affiliation with Morgan's, Incorporated, had been allowed in computing the consolidated net income for the taxable period June 1, 1925, to December 31, 1925, or for the calendar years 1926 and 1927. The deficiency assessed against each petitioner for the year 1927 represents the allocation to each of the deficiency claimed to be due on the basis of net income properly assignable to each corporation as provided in the Revenue Act of 1926, section 240 (b).

Statutes and Regulations Involved.

The Statutes and regulations involved are set forth in Appendix A, pages 25 to 34.

Summary of Argument.

The question involved in this case may be briefly stated as follows:

Where two pre-existing corporations, each keeping its accounts and making its income tax returns for calendar years, become affiliated during a calendar year, and there-

after a consolidated return is filed, including the income of the parent for the whole calendar year and of the subsidiary from the date of affiliation to the end of the calendar year, and the subsidiary files a separate return for the portion of the calendar year from January 1 to the date of affiliation, has that subsidiary during that calendar year filed returns for two taxable years or one taxable year for the purpose of applying the net loss provisions of section 206 of the Revenue Act of 1926?

The precise question in this case is whether the Haines Furniture Company can carry forward against its income for the calendar year 1927 its net loss for the whole calendar year 1925 or is limited to carrying forward its net loss for that portion of the year 1925 after affiliation. The respondents contend that the net loss for the whole calendar year 1925 can be carried forward.

The respondents will argue as follows:

I. The respondents' contention is supported by the authorities.

II. The respondents' contention is supported upon principle, because—

A. By a literal construction of section 200 (a) of the Revenue Act of 1926, the whole calendar year 1925 was the only taxable year of the Haines Furniture Company in that year, instead of that company's having two taxable years in that year as contended by the Commissioner.

B. Under the spirit of the Revenue Act of 1926 and the intent of Congress, the taxable year of the Haines Furniture Company during the year 1925, when it became affiliated, was the whole calendar year 1925, and the Haines Furniture Company is entitled to carry its net loss for the whole calendar year forward over the two succeeding taxable years.

Argument.

I. The respondents' contention is supported by the authorities.

The question presented in this case has arisen and been decided in four circuits, and, in each one of these, favorably to the contention of the respondents. The case in the First Circuit is the present case (Record, p. 23). The case in the Second Circuit is *Arnold Constable Corporation* v. *Commissioner of Internal Revenue,* 69 F. (2d) 788. The case in the Third Circuit is *Crossett Western Company* v. *Commissioner,* decided August 28, 1934, and quoted in full in Appendix B of this brief, beginning on page 34. The case in the Sixth Circuit is *Joseph & Feiss* v. *Commissioner,* 70 F. (2d) 804.

There has been one case decided which the Commissioner contends supports his contentions in this case: *Wishnick-Tumpeer, Inc.,* v. *Commissioner,* decided by the Court of Appeals of the District of Columbia, not yet officially reported, but to be found in vol. 1, Prentice Hall, 1934, page 975. This case may be readily distinguished from the present case and the foregoing cases decided in the Second, Third and Sixth Circuits, which support the respondents' contention in this case.

In the case of Wishnick-Tumpeer, Inc., the parent and subsidiary corporations had different accounting periods. The taxable year of the subsidiary ended October 31 and of the parent December 31.

The question in the Wishnick-Tumpeer case was one involving 1929 taxes, to which the Revenue Act of 1928 and Regulations 75 applied. Article 14 of Regulations 75 reads as follows:

> "Accounting period of an affiliated group.—The taxable year of the parent corporation shall be considered as the taxable year of an affiliated group which makes a

consolidated return, and the consolidated net income must be computed on the basis of the taxable year of the parent corporation."

On January 1, 1929, the parent asked for and received permission to change its accounting period from the calendar year to a fiscal year ending June 30. The parent had filed a separate return for the calendar year 1928, and the subsidiary had filed a separate return for its fiscal year ending October 31, 1928. When the parent changed its taxable year from the calendar year to a fiscal year ending June 30, the parent's taxable year 1929 became, under section 47 (a) of the Revenue Act of 1928, the period from January 1 to June 30, 1929.

When, therefore, a consolidated return was filed by the parent and subsidiary for 1929, the subsidiary automatically changed from one fiscal year to another; and the period consisting of November and December, 1928, was after one taxable year of the subsidiary ended and before the next taxable year of the parent, and consequently of the subsidiary, began. When this happened, the period consisting of November and December, 1928, was squeezed out as a separate accounting period, and, under the provisions of sections 47 (a), (b) and (c) of the Revenue Act of 1928, must be treated as a separate accounting and taxable period for which a separate return had to be filed "for a fractional part of a year." (See also Regulations 74, article 371.)

Such a period was within the express words of section 117 (b) of the Revenue Act of 1928 defining the words "taxable year." The sentence relevant (which is also included under section 200 (a) of the Revenue Act of 1926) reads as follows:

"The term 'taxable year' includes, in the case of a return made *for a fractional part of the year* under the

provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made." (Italics ours.)

Furthermore, under the provisions of article 41 (d) of Regulations 75, the return for the period November and December, 1928, was for a "taxable year." Section 41 (d) reads as follows:

> "Taxable year.—Any period of less than twelve months for which either a separate return or a consolidated return is filed, under the provisions of article 13, shall be considered as a taxable year."

By sections 141 (a) and (b) of the Revenue Act of 1928, each corporation in the affiliated group making the consolidated return consents to the regulations made by the Commissioner and the Commissioner is given the power to make regulations relative to the filing of consolidated returns.

It would seem, therefore, that in the Wishnick-Tumpeer case the return of the subsidiary for the period consisting of November and December, 1928, is a return for a taxable year, first, because the regulations of the Commissioner so state, and secondly, because it is a return for a separate accounting period that is squeezed out when a taxpayer changes its taxable year.

The situation is entirely different in the present case. Section 240 (a) of the Revenue Act of 1926 provides that affiliated corporations may make consolidated returns under regulations prescribed by the Commissioner with the approval of the Secretary.

The Commissioner then prescribed by Regulations 69, article 634. Under these regulations he did not prescribe that a return made for the first portion of the taxable year of a subsidiary prior to affiliation should be a return for a

taxable year, as he did in article 41 (d) of Regulations 75, or in fact that the return for such period should be a return "for a fractional part of a year" in the sense that the last-quoted phrase is used in the Statute and regulations. As appears from articles 431, 625 and 651 of Regulations 69, a return "for a fractional part of a year" refers to a return for a separate accounting period where that accounting period is less than twelve months. But in the situation presented in the present case there was no change of accounting period. Both parent and subsidiary always used the calendar year as their respective accounting periods. In such a situation article 634 of Regulations 69 evidently does not regard the separate return which it requires a subsidiary to file (in this case the Haines Furniture Company for the period January 1 to May 31, 1925) as a return "for a fractional part of a year," and hence for "a taxable year." The regulation expressly states that this is a return "for that part of the taxable year" and "for the portion of the taxable year during which they were not affiliated"; and, contrary to returns "for a fractional part of a year," this return is not due "until the fifteenth day of the third month following the close of the taxable year." This separate return is expressly a return for a *portion* of a *taxable year*. Similarly, the consolidated return filed includes the income of the subsidiary "to the end of the taxable year." We do not see how it can be said with any consistency, therefore, that either return is for a whole taxable year of the subsidiary, or "for a fractional part of a year," which is said by the Statute to be a taxable year. In the Wishnick-Tumpeer case, on the other hand, the separate return for November and December, 1928, is by law a return for a separate accounting period and "for a fractional part of a year." It comes, therefore, within the express words of the Statute. It also comes within the express words of the regulations applicable in 1929 defining the taxable year.

Beneficial Loan Society v. *United States,* 48 F. (2d) 686, specifically considers the definition of the words "taxable year" as used in section 200 (a) of the Revenue Act of 1926 and supports the respondents' contentions in the present case. In that case the taxpayer had been affiliated until May 1, 1925. Its income for the period from February 1, 1925, to April 30, 1925, was included in the consolidated return. It made a separate return for the period from May 1, 1925, to January 31, 1926, and contended that said return was for a "taxable year." The Court in overruling the contention said (page 687):

> ". . . But this contention is not true. The plaintiff was in existence for its entire fiscal year of twelve months ending January 31, 1926, and previous thereto. Until May 1, 1925 plaintiff was affiliated with another corporation and the consolidated return was the return of the plaintiff until affiliation ceased, and this is true whether the consolidated return was filed by or in the name of another corporation as the parent company. It was the return of the plaintiff as much as if it had been a separate return. Each member of the affiliated group at all times retained its separate identity and was a separate taxpayer under the statute . . . Under Section 226 (b) of the Revenue Act of 1926, in Article 634 of Regs. 65 and 69, plaintiff was required to make and file a separate return for the period May 1, 1925, the date of the termination of the affiliation, to the end of its taxable year, January 31, 1926. . . . *The separate return filed by plaintiff for the period May 1, 1925 to January 31, 1926, was not a return for a 'taxable year' any more than was the consolidated return for three months of the plaintiff's fiscal year a return by it for a taxable year. Under the facts there was merely a change in the basis of reporting net income which re-*

quired the plaintiff to file a return for a fractional part of a year.'' (Italics ours.)

The taxpayer's petition for certiorari in the Beneficial Loan case was denied (284 U.S. 633).

II. The respondents' contention is supported upon principle, because—

A. By a literal construction of section 200 (a) of the Revenue Act of 1926, the whole calendar year 1925 was the only taxable year of the Haines Furniture Company in that year, instead of that company's having two taxable years in that year as contended by the Commissioner.

The contention of the Commissioner is based upon the definition of the term ''taxable year'' in section 200 (a) of the Revenue Act of 1926 and especially in the third sentence, which reads as follows:

> ''The term 'taxable year' includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made.''

That sentence has an interesting legislative history. It first appeared in the Revenue Act of 1924. The reason for its appearance is contained in the majority report of the Ways and Means Committee on the Revenue Act of 1924, quoted in the opinion of the Court below (Record, page 26). That quotation reads as follows:

> ''In subdivision (a) of this section the term 'taxable year' is defined to include a period of less than a year when a return is made for such period. Under the exist-

> ing law the use of the term 'taxable year' in the 'net loss' section and other sections has been construed not to cover the case of a return made by a taxpayer for a fractional part of a year, with the result that the benefits of such sections are denied to taxpayers who are required by law to make a return for a fractional part of a year."

This was thus a relief measure and should be liberally construed in favor of the taxpayer. To construe it the way the Commissioner contends would be to deny a right the taxpayer otherwise had; and would give the taxpayer the right to carry forward losses for a period of one year and seven months rather than for the two years which the Statute contemplates.

Therefore, the first question is to determine whether the Statute and the regulations, even if they are construed literally, require that unjust result. If they do not, obviously it should not be reached.

As we have said, but for the affiliation it is perfectly clear that the Haines Furniture Company could have used its whole loss for the year 1925 as a deduction from 1927 income. Let us see how affiliation has changed the situation.

The Statute relating to consolidated returns is section 240 (a) of the Revenue Act of 1926, appearing in Appendix A, page 26. This Statute does not direct how consolidated returns should be made, but leaves that problem to the regulations.

Under article 634 of Regulations 69 (Appendix A, page 28) the Haines Furniture Company was required as a subsidiary in the affiliated group to file "a separate return for that part of the taxable year" prior to affiliation and to include its income for the balance of the taxable year in the income of a consolidated return filed by the whole group.

This simply means, as the Circuit Court of Appeals in the Second Circuit said in *Commissioner* v. *Ginsberg*, 54 F. (2d) 238:

> "Even though both corporations were affiliated in 1927, they each remained taxpayers, and their affiliation merely made them a tax-computing unit. . . . It is not a taxable unit."

This language of the Circuit Court of Appeals was approved by the Supreme Court in *Woolford Realty Co., Inc.*, v. *Rose*, 286 U.S. 319, where the Court decided that each member of a consolidated group retains its identity as a taxpayer. The accounting period of each separate taxpayer is not changed by such affiliation. Accordingly, the accounting period of the Haines Furniture Company was still the calendar year. Therefore the return filed by the Haines Furniture Company for the period January 1 to May 31, 1925, was not a return for a complete accounting period except when combined with the income which was included in the consolidated return for the balance of the year.

Furthermore, the taxable year was not ended by the affiliation, but still remains the calendar year. This was so held in *United States* v. *Hoffman*, 61 F. (2d) 294; *Sweets Company of America, Inc.*, v. *Commissioner*, 40 F. (2d) 436; *Beneficial Loan Soc.* v. *United States*, 48 F. (2d) 686 (certiorari denied, 284 U.S. 634). Regulations 69, promulgated August 28, 1926, after the Revenue Act of 1926 became law, specifically recognized that the taxable year of a subsidiary does not end upon affiliation. These regulations do not provide (see article 634, Appendix A, page 28) that the subsidiary must make a separate return for a taxable year or for a fractional part of a year, but a "separate return for *that part of the taxable year* during which it was outside the affiliated group"; and further provide for a consolidated

return "from the date of change of stock ownership *to the end of the taxable year.*"

Thus the only effect of the regulations upon the returns of affiliated corporations is that two separate returns must be made for each subsidiary during the accounting period or taxable year. The regulations correctly assume the accounting period and the taxable year to be the same twelve months they were prior to affiliation.

We maintain, accordingly, that neither of these separate returns alone is for a "taxable year" as the words are used in the Statute; but that both of these separate returns together constitute one complete return for a taxable year, split up, however, for the convenience of the Commissioner, into two physical parts. We further contend that neither of these separate returns is a return for a "fractional part of a year" as those words are used in the Statute.

We start with the proposition laid down by the Supreme Court in *Woolford Realty Co., Inc.*, v. *Rose*, 286 U.S. 319, 326:

> "The general principle underlying the income tax statutes ever since the adoption of the 16th Amendment has been the computation of gains and losses on the basis of an annual accounting for the transactions of the year."

We therefore want to avoid any deviation from the annual where we can. The idea of two separate accountings for the same accounting period is to be avoided. An accounting period is to be twelve months wherever possible. The phrase "return for a fractional part of a year," we accordingly contend, applies merely to a case where, by necessity, an accounting period is less than twelve months and a return is made for a complete accounting period. Such cases are numerous.

For example, where a man dies during a year, naturally his accounting period is less than twelve months. Similarly, where a corporation is liquidated during a year or where there is a change from a fiscal year to a calendar year or *vice versa,* an extra accounting period of less than a year necessarily emerges. Such situations are covered by Regulations 69, articles 431 (Appendix A, page 26), 625 (Appendix A, page 27) and 651 (Appendix A, page 29), promulgated under sections 226 and 239 of the Revenue Act of 1926.

It is interesting to note that the return filed in each one of these cases is for an accounting period of less than twelve months and is everywhere referred to in the Statute and regulations as a return for a "fractional part of a year," in those words. We again call attention to articles 431, 625 and 651 of Regulations 69.

But when we come to the case of consolidated returns for two or more affiliated corporations, the situation is wholly different. The Statute does not direct how such returns are to be made, but leaves that problem to the regulations. Accordingly, the Statute does not call such returns "returns for a fractional part of a year."

When we examine the language of article 634 of Regulations 69 (Appendix A, page 28), we find also that the regulations do not refer to the two separate returns that they require to be filed by the subsidiary as "returns for a fractional part of a year." The regulations might have provided in case of affiliation in these words: "A separate return shall be filed by each subsidiary for the fractional part of the year prior to affiliation."

Instead, however, we find express words in an entirely different vein. The regulations expressly say "the subsidiary or subordinate corporation, whose status is changed *during the taxable year* should make a separate return for that *part of the taxable year* during which it was outside the affiliated group." (Italics ours.)

That return is, by express words, not a return for a taxable year, but only for a part of one. A return for a part of the taxable year cannot be a return for a taxable year. Hence the period for which that return is made is not a taxable year, but only a portion of one.

Now let us complete that taxable year. That is provided for in the preceding paragraph of article 634:

> ". . . a consolidated return should be filed from the date of change of stock ownership to the *end of the taxable year*, including therein the income of the subsidiary or subordinate corporation for such period." (Italics ours.)

Thus the rest of the taxable year is dealt with. The regulations do not purport to create two taxable years where one existed before and do not purport to call for separate returns for separate accounting periods. If the words "return for a fractional part of a year" are to be given the meaning that we think is to be applied to them, article 634 does not call for returns for fractional parts of a year. On the contrary, that article merely states that the return for one taxable year shall be split into two physical parts for the convenience of the Commissioner.

The contention of the Commissioner that this method devised by the Commissioner for his convenience, without in fact changing the accounting period or taxable year of the taxpayer, makes two taxable years grow where only one grew before, especially where the Commissioner himself considers that there is only one taxable year, seems without any basis. The words "part of a taxable year," "portion of a taxable year," and "to the end of the taxable year," used by the Commissioner, indicate clearly that the taxable year of a subsidiary is not changed by affiliation, in spite of the fact that two returns are required to be filed.

That such was the intent of the regulations is brought out clearly by the following two sentences from article 634 of Regulations 69:

> "Where corporations become affiliated during the taxable year the separate returns of the corporations for the portion of the taxable year during which they were not affiliated will not be due until the fifteenth day of the third month following the close of the taxable year. For example, if two corporations become affiliated on July 1, 1926, and elect to file a consolidated return for the period from July 1 to December 31, 1926, the separate returns of the corporations covering the period from January 1 to June 30, 1926, will be due on March 15, 1927."

If each of these separate returns were for a taxable year, then the return of the Haines Furniture Company for the period from January 1 to May 31, 1925, should have been filed on September 15, 1925, instead of on March 15, 1926, under the following provisions of section 227 (a) of the Revenue Act of 1926:

> "Returns (except in the case of nonresident aliens) shall be made on or before the fifteenth day of the third month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made on or before the 15th day of March."

The situation may be summarized briefly. Section 200 (a) says that the term "taxable year" shall "include," in the case of returns made for a fractional part of a year under regulations prescribed by the Commissioner, the period for which the return is made. Section 240 (a) says that affiliated corporations may make consolidated returns under

regulations prescribed by the Commissioner. The regulations prescribed by the Commissioner state that a subsidiary corporation shall make two separate returns during "the taxable year" within which it is affiliated. If the Statute says that a fractional part of a year is a taxable year, then a part of a taxable year cannot be "a fractional part of a year" in the sense the quoted words are used in the Statute. The two things are wholly inconsistent. The intention of the Commissioner in promulgating the regulations is clearly not to require two separate returns for fractional parts of a year but to require what he expressly says; namely, a division of a return for a whole taxable year into two physical parts.

And there is reason for the procedure adopted by the Commissioner. Look at the last sentence of section 200 (a). This provides "the first taxable year, to be called the taxable year 1925, shall be the calendar year 1925 or any fiscal year ending during the calendar year 1925." If, as was stated in the case of *Arnold Constable Corporation* v. *Commissioner of Internal Revenue,* 69 F. (2d) 788, the Commissioner's contention should be adopted and there should be affiliations with a number of corporations at different dates within the same year (a not unusual case), there might be countless taxable years in the calendar year ending in 1925, whereas the Statute seems to contemplate but one.

Accordingly, and in view of the fact (1) that the principle underlying our income tax statutes is that of a tax on income based on annual accountings rather than on two accountings in the same year, (2) that the accounting period of the Haines Furniture Company has not been changed by affiliation, but has remained constant as the calendar year, (3) that the taxable year of the Haines Furniture Company does not end upon affiliation but continues to the end of the calendar year, and (4) that the regulations intend and expressly provide, not that the Haines Furniture

Company shall file two separate returns for two separate accounting periods in 1925, but that it shall file a return for the whole accounting period or taxable year in two physical parts and do not provide that its taxable year shall be split into two taxable years, we must logically come to the conclusion that, even under the literal words of the Statute, the only "taxable year" of the Haines Furniture Company in the calendar year 1925 was the whole calendar year.

To reach this result we can proceed upon either one of two bases:

The first is that the words "a return made for a fractional part of a year" do not include all returns filed which include income for a period of less than twelve months, but only include returns filed for accounting periods of less than twelve months. This is certainly a reasonable definition of the words and clearly within the intent of the Commissioner as expressed by his regulations and within the intent of Congress as shown by the Statute.

The second basis is that the third sentence of section 200 (a) does not apply to our case, for a slightly different reason. That sentence says that the taxable year "includes" certain periods shorter than twelve months. It does not say that the taxable year "shall be" each period less than twelve months for which a return is filed. When a taxpayer, such as the Haines Furniture Company in this case, already has a perfectly clear and definite accounting period and taxable year of twelve months, there is no necessity for invoking the definition of taxable year contained in that third sentence, because the taxable year already "means the calendar year" as provided in the first sentence of section 200 (a). That is, the third sentence was designed only to deal with situations not covered by the two preceding sentences; and the situation of the Haines Furniture Company was covered by the first sentence of the section.

II. B. Under the spirit of the Revenue Act of 1926 and the intent of Congress, the taxable year of the Haines Furniture Company during the year 1925, when it became affiliated, was the whole calendar year 1925, and the Haines Furniture Company is entitled to carry its net loss for the whole calendar year forward over the two succeeding taxable years.

Even if we suppose that the words "return made for a fractional part of a year" might possibly be construed to include the separate returns required by the regulations to be filed by a subsidiary corporation during the taxable year of its affiliation, it is clear that such construction was not the intent of Congress.

As was said by the Court below, section 200 (a) should be construed to conform with the general scheme of the income tax acts as to accounting periods and the purpose of Congress in allowing net losses to be spread forward over a two-year period.

We do not think we can improve upon the reasoning of the Court below and its statement with respect to this feature of the case. On pages 26, 27 and 28 of the record the Court below said:

> "The provisions allowing a spread of net loss in one year to be deducted from the net income of the two succeeding years, first appeared in the act of 1921, sec. 204 (b), though a provision was inserted in the 1918 act, sec. 204 (b), permitting net losses for any year be- 1, 1920, to be deducted from the net income of the next prior year.
>
> "The purpose of both acts, it has been recognized by the courts and by the Board of Tax Appeals, was to provide a relief for taxpayers who might suffer severe losses in the year immediately following the close of

the war in 1918, to deduct their losses from the war profits of 1918, and to allow losses of any one year during the period of readjustment of business after the war to be spread over a period of three years, in case there was not income earned during either of the two succeeding years after the loss occurred. Sec. 200 of the 1924 and 1926 acts should be so construed as to allow the relief granted by sec. 204 (b) and 206 (b) of these acts, and not to curtail it.

"The Supreme Court has construed the Income Tax Acts since 1913 as, in general, defining the accounting period as a period of twelve months. Burnet v. Sanford & Brooks Co., 282 U.S. 359, 363, in which the court said:

" 'All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt.' Also see Woolford Realty Co., Inc., v. Rose, 286 U.S. 319, 326.

"Why, then, did Congress add the further definition of a taxable year as including a shorter period and was it intended to affect the provisions of sec. 204 (b)?

"The majority of the Ways and Means Committee on the Revenue Act of 1924, H.R. 6715, when this added definition first appears, referring to sec. 200, says:

"In subdivision (a) of this section the term 'taxable year' is defined to include a period of less than a year when a return is made for such period. Under the existing law the use of the term 'taxable year' in the 'net loss' section and other sections has been construed not to cover the case of a return made by a taxpayer for a fractional part of a year, with the result that the

benefits of such sections are denied to taxpayers who are required by law to make a return for a fractional part of a year.' Similar language was contained in the report of the Senate Committee on Finance.

"The Commissioner of Internal Revenue had, prior to the enactment of the 1924 act, construed secs. 200 and 204 (b) of the 1921 act strictly, and held that a taxpayer beginning business or going out of business during a fiscal or calendar year, or in case of a change in the accounting period during a taxable year from a fiscal to a calendar year, or vice versa, was not entitled to the relief provided in sec. 204 (b), and had refused to allow as a deduction in a succeeding year net losses incurred in any fractional part of a year for which the taxpayer was required to file a return, because a fractional part of a year was not a taxable year within the meaning of secs. 200 and 204 (b) of that act. Appeal of Carroll Chain Co., 1 B.T.A. 38; Appeal of Patapsco Ballast Co., 1 B.T.A. 1081; Appeal of Joe Siegal, Inc., 1 B.T.A. 1113; Appeal of Tacoma Grocery Co., 1 B.T.A. 1061, in which cases there were appeals from his decisions.

"It is clear, we think, that Congress, as was indicated in the report of its committees, added the further definition of a taxable year to sec. 200 in order that a taxpayer required to make a return for a fractional part of a year, which by reason of a change in its accounting period was not a part, either of its prior or new annual accounting period, should clearly have the benefit of sec. 204 (b) as to losses suffered during that fractional period, a right which the Commissioner in his construction of sec. 200 of the 1921 act had previously denied him.

"The added definition of a taxable year was in furtherance of the relief granted in sec. 204 (b) of the

1921 act, and was not intended as a curtailment thereof by shortening the period over which net losses might be spread, and to repudiate the strict construction of sec. 200 and 204 (b) previously enforced by the Commissioner.

"Sec. 200 of the 1924 and 1926 acts, therefore, should not be construed, as has been done in this case, to deprive a corporation, which has hitherto been doing business and making its return on a calendar year, and which suffered a loss during the calendar year 1925, of the right to spread that loss over the two succeeding years, because, in accordance with Treasury Regulations 69, art. 634, it made a separate return of its income during the period from January 1 to May 31, 1925, having on May 31 become affiliated with another corporation and joined in a consolidated return for the period from June 1 to December 31, 1925, in which return only its loss suffered during the latter period was absorbed.

"Affiliated taxpayers do not become a single taxable unit, but merely a single tax-computing unit. Woolford Realty Co. Inc. v. Rose, supra; Commissioner v. Ginsberg, 54 Fed. (2d) 238; United States v. Hoffman et al., 61 Fed. (2d) 294; Sweets Company of America, Inc. v. Commissioner, 40 Fed. (2d) 436. The Haines Company, therefore, retained its status as a separate 'taxable unit' for the entire calendar year 1925. Its net losses and net income were determined by its business for the full calendar year. After affiliation its ness for the full calendar year. After affiliation its proportionate net loss absorbed in the affiliating return was, or should have been, determined in accordance with art. 634 of the regulations 65, and sec. 240 of the 1924 act.

"A liberal construction of sec. 200 as amended in 1924 requires that so much of the net losses of the

> Haines Company during 1925 as were not absorbed in the consolidated return, should be deducted from its net income in 1927, under sec. 204 (b) of the 1924 act, and sec. 206 (b) of the 1926 act. The fact that it became a part of another tax-computing unit on June 1, 1925, did not change its status as a taxable unit for that year. It was still a 'taxable unit' for the full calendar year of 1925, which constituted its taxable year. Beneficial Loan Soc. of Bethlehem v. United States, 48 Fed. (2d) 686. (Certiorari denied 284 U.S. 633.) For an able discussion of the proper construction of sec. 200, also see the dissenting opinion of Member Van Fossan in the case of Weissberger Moving & Storage Company, Inc. v. Commissioner, 26 B.T.A. 1375, 1377."

This seems to us to be a clear and logical exposition to which we have to add only the following observations:

The Circuit Court in the case of *Arnold Constable Corporation* v. *Commissioner of Internal Revenue*, 69 F. (2d) 788, 790, tested the Commissioner's contention by an extreme example and stated the result as follows:

> ". . . Should there be affiliations with a number of corporations at different dates in the same year (a not unusual case) the taxpayer might essentially lose the right to deduct the prior year's loss from profits accruing during a period of more than a few days. Such a result is certainly repugnant to the purpose of the statute modeled in general on the English Act and intended in a measure to stabilize income taxes for periods of three full years."

We believe that the result achieved by the Court below is perfectly warranted by principles of statutory construction. In *Helvering* v. *New York Trust Company*, 78 L. ed. 960, 963, this Court said:

"The rule that where the statute contains no ambiguity, it must be taken literally and given effect according to its language is a sound one not to be put aside to avoid hardships that may sometimes result from giving effect to the legislative purpose. Commr. of Immigration v. Gottlieb, 265 U.S. 310, 313. Bate Refrigerating Co. v. Sulzberger, 157 U.S. 1, 37. But the expounding of a statutory provision strictly according to the letter without regard to other parts of the Act and legislative history would often defeat the object intended to be accomplished. Speaking through Chief Justice Taney in Brown v. Duchesne, 19 How. 183, this court said (p. 194): 'It is well settled that, in interpreting a statute, the court will not look merely to a particular clause in which general words may be used, but will take in connection with it the whole statute (or statutes on the same subject) and the objects and policy of the law, as indicated by its various provisions, and give to it such a construction as will carry into execution the will of the Legislature, as thus ascertained, according to its true intent and meaning.' Quite recently in Ozawa v. United States, 260 U.S. 178, we said (p. 194): 'It is the duty of this court to give effect to the intent of Congress. Primarily this intent is ascertained by giving the words their natural significance; but if this leads to an unreasonable result, plainly at variance with the policy of the legislation as a whole, we must examine the matter further. We may then look to the reason of the enactment, and inquire into its antecedent history, and give it effect in accordance with its design, and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail.' And in Barrett v. Van Pelt, 268 U.S. 85, 90, we applied the rule laid down in The People v. Utica Ins. Co., 15 Johns. 358, 381, that 'a thing which is within the intention of the makers of a statute is as much within the statute as if it were

within the letter; and a thing which is within the letter of a statute, is not within the statute, unless it be within the intention of the makers.' "

And on page 965 this Court further said:

"Mere change of language does not necessarily indicate intention to change the law. The purpose of the variation may be to clarify what was doubtful and so to safeguard against misapprehension as to existing law. In view of the inclusion of the same definition in the Acts of 1921, 1924 and 1926 and the legislative purpose underlying it, the contention that the new words were added to change the meaning of 'capital assets' as defined in the earlier Acts is without force. The definition so clarified was not new law but 'a more explicit expression of the purpose of the prior law.' Jordan v. Roche, 228 U.S. 436, 445. Merle-Smith v. Commissioner, 42 F. (2d) 837, 842. McCauley v. Commissioner, 44 F. (2d) 919, 920."

Conclusion.

We submit that a literal construction of the Statute establishes the contention of the respondents; that under the spirit of the tax law and the intent of Congress no other contention is justifiable; and that the overwhelming weight of authority supports that contention. The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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Appendix A.

Material Portions of Statutes and Regulations Involved.

Revenue Act of 1926, C. 27, 44 Stat. 9.

Section 200.

(a) The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The term "taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made. The first taxable year, to be called the taxable year 1925, shall be the calendar year 1925 or any fiscal year ending during the calendar year 1925. (26 U.S.C.A. section 931 (a).)

Section 206.

(b) If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary. (26 U.S.C.A. section 937 (b).)

Section 240.

(a) Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner. (26 U.S.C.A. section 993 (a).)

Section 240.

(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit computed as provided in subdivision (b) of section 236. (26 U.S.C.A. section 993 (b).)

TREASURY REGULATIONS 69, PROMULGATED UNDER THE REVENUE ACT OF 1926.

Article 431.

Returns for periods of less than 12 months. No return can be made for a period of more than 12 months. A separate return for a fractional part of a year is therefore required wherever there is a change, with the approval of the Commissioner, in the basis of computing net income from one taxable year to another taxable year. The periods

to be covered by such separate returns in the several cases are stated in the statute. The requirements with respect to the filing of a separate return and the payment of tax for a part of a year are the same as for the filing of a return and the payment of tax for a full taxable year closing at the same time. (See sections 227 and 270 and articles 441-447 and 1201.) The tax in net income computed on the basis of the period for which a separate return is made shall be paid thereon at the rate for the calendar year in which such period is included. In case of a change in the accounting period the net income computed on the return for the fractional part of a year shall be placed on an annual basis and the tax computed as provided in section 226 (c). See further section 212 and articles 25 and 26, and as to corporations, sections 232 and 239 and articles 531 and 625.

Since it is not required that income be placed on an annual basis except where the taxpayer voluntarily changes his accounting period, the income of a decedent or of his estate for the fractional parts of the year in which he died need not be placed on an annual basis.

Article 625.

Returns for fractional part of year. If a corporation, with the approval of the Commissioner, changes its accounting period from calendar year to fiscal year, from fiscal year to calendar year, or from one fiscal year to another fiscal year, a separate return shall be made for a fractional part of a year and the net income on such return shall be placed on an annual basis as provided in section 226 (c). (See article 431.) In all other cases the credit of $2,000 against net income allowed a domestic corporation having a net income not exceeding $25,000 shall be reduced to such proportion of the full credit as the number of months in the period for which the return is made bears to 12 months.

Article 634.

Change in ownership during taxable year. (a) Where corporations are affiliated at the beginning of a taxable year but due to a change in stock ownership during the year the affiliated status is terminated, or (b) where corporations are not affiliated at the beginning of the taxable year but through change of stock ownership during the year become affiliated, a full disclosure of the circumstances of such changes of stock ownership shall be submitted to the Commissioner.

Ordinarily in such cases, where only two corporations are involved, the parent or principal corporation, under the conditions described in (a) above, should file a consolidated return including the income of such subsidiary or subordinate corporation to the date of the change of stock ownership, and each should file a separate return from the date of such change in stock ownership to the end of the taxable period, and, under the conditions described in (b) above, each corporation should file a separate return from the beginning of the taxable period to the date of the change in stock ownership, and a consolidated return should be filed by the parent or principal corporation from the date of change of stock ownership to the end of the taxable year, including therein the income of the subsidiary or subordinate corporation for such period.

Where there are more than two corporations affiliated at the beginning of the taxable year, and due to a change in stock ownership the affiliated status of one or more is terminated, but there remain at least two corporations affiliated during the entire year, the parent or principal corporation should file a consolidated return for the entire year, excluding from its return the income of the corporations whose affiliated status is terminated from the date of the change in stock ownership; or where two or more corporations are affiliated at the beginning of the taxable year,

and through change in stock ownership additional corporations become affiliated, the parent or principal corporation should file a consolidated return and include the income of such corporations from the date of change of stock ownership. In either case, the subsidiary or subordinate corporation whose status is changed during the taxable year should make a separate return for that part of the taxable year during which it was outside of the affiliated group.

Where, in accordance with the procedure set forth above, a return is made by a corporation for a period less than a year, the tax shall be computed in accordance with sections 226 and 239 and the articles thereunder. Where corporations become affiliated during the taxable year the separate returns of the corporations for the portion of the taxable year during which they were not affiliated will not be due until the fifteenth day of the third month following the close of the taxable year. For example, if two corporations become affiliated on July 1, 1926, and elect to file a consolidated return for the period from July 1 to December 31, 1926, the separate returns of the corporations covering the period from January 1, to June 30, 1926, will be due on March 15, 1927. In any case in which the change of affiliated status is for a period so short as to be negligible, a consolidated return or separate returns for the entire period, as the case may be, may be filed; in such cases, however, there should accompany the return a complete statement setting forth the changes in the affiliated status occurring during the taxable year.

Article 651.

Time and place for filing returns. Returns of income must be made on or before the fifteenth day of the third month following the close of the fiscal or calendar year, as provided in section 227 and articles 441-447. In the case of foreign corporations not having any office or place of business in the

United States, however, returns shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, on or before June 15. A corporation going into liquidation during any taxable year may upon the completion of such liquidation prepare a return covering its income for the fractional part of the year during which it was engaged in business and may immediately file such return with the collector. A corporation having an office or agency in the United States must make its return to the collector of the district in which is located its principal office or agency. Other corporations must make their returns to the collector at Baltimore.

REVENUE ACT OF 1928, C. 852, 45 STAT. 795.

Section 47.

(a) *Returns for Short Period Resulting from Change of Accounting Period.* If a taxpayer, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year. (26 U.S.C.A. section 2047 (a).)

Section 47.

(b) *Income Computed on Basis of Short Period.* Where a separate return is made under subsection (a) on account

of a change in the accounting period, and in all other cases where a separate return is required or permitted, by regulations prescribed by the Commissioner with the approval of the Secretary, to be made for a fractional part of a year, then the income shall be computed on the basis of the period for which separate return is made. (26 U.S.C.A. section 2047 (b).)

Section 47.

(c) *Income Placed on Annual Basis.* If a separate return is made under subsection (a) on account of a change in the accounting period, the net income, computed on the basis of the period for which separate return is made, shall be placed on an annual basis by multiplying the amount thereof by twelve and dividing by the number of months included in the period for which the separate return is made. The tax shall be such part of the tax computed on such annual basis as the number of months in such period is of twelve months. (26 U.S.C.A. section 2047 (c).)

Section 117.

(b) *Net Loss as a Deduction.* If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary. (26 U.S.C.A. section 2117 (b).)

Section 141.

(a) *Privilege to File Consolidated Returns.* An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group. (26 U.S.C.A. section 2141 (a).)

Section 141.

(b) *Regulations.* The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability. (26 U.S.C.A. section 2141 (b).)

REGULATIONS 74, PROMULGATED UNDER THE REVENUE ACT OF 1928.

Article 371.

Returns for periods of less than 12 months. No return can be made for a period of more than 12 months. A separate return for a fractional part of a year is therefore required wherever there is a change, with the approval of the Commissioner, in the basis of computing net income from one taxable year to another taxable year. The periods to be covered by such separate returns in the several cases are stated in the Act. The requirements with respect to the filing of a separate return and the payment of tax for a part of a year are the same as for the filing of a return and the payment of tax for a full taxable year closing at the same time. (See sections 53 and 56 and articles 401-404, 431 and 746.) The tax on net income computed on the basis of the period for which a separate return is made shall be paid thereon at the rate for the calendar year in which such period is included. Where a return is made for a fractional part of a year, except where a return is made for a period of less than 12 months by reason of a change in accounting period, the personal exemption and credit for dependents, and the credit of $3000 allowed a domestic corporation having a net income not exceeding $25,000, shall be reduced to that proportion of the full credit which the number of months in the period for which the return is made bears to 12 months.

In case of a change in accounting period the net income computed on the return for the fractional part of a year shall be placed on an annual basis and the tax computed as provided in section 47 (c). Where the net income of a corporation is placed on an annual basis, the amount of the net income after being placed on such basis determines whether the credit of $3000 is allowable.

REGULATIONS 75

RELATING TO CONSOLIDATED RETURNS OF AFFILIATED CORPORATIONS PRESCRIBED UNDER SECTION 141 (B) OF THE REVENUE ACT OF 1928.

(Applicable to the taxable year 1929 and subsequent taxable years.)

Section 41.

(d) *Taxable Year.* Any period of less than 12 months for which either a separate return or a consolidated return is filed, under the provisions of article 13, shall be considered as a taxable year.

APPENDIX B.

CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

CROSSETT WESTERN COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Review of Decision of the United States Board of Tax Appeals.

(Decided August 28, 1934.)

Before Woolley, Davis and Thompson, Circuit Judges.

DAVIS, Circuit Judge. This petition involves the liability of the Crossett Western Company, the petitioner, for deficiencies assessed by the Commissioner in income taxes for the years 1924 and 1929. The Board of Tax Appeals approved the deficiency assessments. 27 B. T. A. 258.

From 1924 to 1930, the petitioner carried on extensive operations in lumber and allied businesses in the States of Oregon and Washington. Another corporation, the Gates

Creek Logging Company, hereinafter called the Gates Company, was engaged in logging timberlands in Oregon. The Gates Company was managed, and was considered, as a unit of the petitioner. The meetings of the stockholders and directors of the two companies were held together; the management of the companies was the same; supplies were purchased at wholesale prices which were prorated; employees and equipment were interchanged frequently. In January, 1924, a uniform cost accounting and bookkeeping system was installed for the petitioner and the Gates Company.

At the end of 1924, members of several families, the Crossett, Watzek and Gates, were the dominating influence in the two companies. Six members of the Crossett family owned approximately 57 per centum of the petitioner's stock, 10 members of the Watzek family owned 27 per centum, 8 members of the Gates family owned 11 per centum, and 3 of the employees owned 3 per centum; the petitioner owned approximately 73 per centum of the stock of the Gates Company, 2 members of the Crossett family owned 2 per centum, 5 members of the Watzek family owned 4 per centum, and 1 member of the Gates family owned 2 per centum, and 8 of the employees owned 17 per centum. The employees who owned stock took no part in the management of the companies and their stock was voted by proxy.

The holdings of the Gates Company stock changed so that in 1925, the petitioner owned approximately 80 per centum and 9 of its stockholders owned 17 per centum; and in 1926, the petitioner owned approximately 83 per centum and 8 of its stockholders owned 14 per centum.

On November 15, 1928, the petitioner had acquired 97.966 per centum of the Gates Company stock.

The Gates Company was operated with losses during the period from 1924 to 1929. For those years the petitioner and the Gates Company filed consolidated income tax re-

turns on the ground that they were affiliated and also requested the Commissioner to consolidate the accounts of the two companies. The Commissioner determined that the companies became affiliated first on November 15, 1928, and were not entitled to file consolidated returns until that time, and that the period from January 1, 1928, to the date of affiliation was one "taxable year" and the period from November 15, 1928 to the end of the year another "taxable year" for which a separate return must be filed under section 48 of the Revenue Act of 1928; and finally that the petitioner was not entitled to consolidate the accounts of the companies in 1924 under section 240 (d) of the Revenue Act of 1924.

The petitioner and the Gates Company were not affiliated prior to November 15, 1928, under section 240 (c) of the Revenue Act of 1924 and 1926 and section 142 (c) of the Act of 1928. These sections in the various acts are identical and provide that:

> For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 per centum of the voting stock of the other or others, or (2) if at least 95 per centum of the voting stock of two or more corporations is owned by the same interests.

They require for affiliation that one corporation own at least 95 per centum of the voting stock of the other, or that the same interests shall own not only 95 per centum of the voting stock of the other but, shall own in substantially the *same proportions* at least 95 per centum of the stock of the two companies. This is clear from our decision in *Commissioner* v. *Samuel Bell and Sons,* 67 Fed. (2d) 175, and from the decision of the Supreme Court in *Handy and Harmon* v. *Burnet,* 284 U. S. 136, 140.

Likewise, the Commissioner was not required to consolidate the accounts of the two companies at the request of the petitioner. Section 240 (d) of the Act of 1924 permits the Commissioner to do so "if necessary in order to make an accurate distribution or apportionment of gains, profits, income, deductions or capital between or among" related businesses owned or controlled directly or indirectly by the same interests. The Commissioner determined that consolidation of the accounts was not necessary and we are unable to say from the general nature of the facts found in the record that his determination was arbitrary.

As to the third question involved in this case, whether or not the filing of two returns in 1928 constituted two taxable years and precludes allowance in 1929 of deductions for losses suffered in previous years, we think the construction of the Commissioner and the Board of Tax Appeals of sections 48 and 117 of the Revenue Act of 1928, and of Article 733 of Treasury Regulations 74, is untenable.

Article 733 provides that where corporations are not affiliated at the beginning of the taxable year, but through change of stock ownership (as in the instant case) during the year become affiliated "each corporation should make a separate return from the beginning of the taxable period to the date of the change in stock ownership, and a consolidated return should be made by the corporation from the date of the change of stock ownership to the end of the taxable year, including therein the income of both corporations for such period."

Under that provision both corporations had to make separate returns for 1928 from January 1, 1928 to November 15, 1928 and a consolidated return from and including November 16, 1928 to December 31, 1928.

Section 117 (b) of the Act of 1928 provides:

> Net loss as a deduction.—if, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year",) and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year") the deduction in all cases to be made under the regulations prescribed by the Commissioner with the approval of the Secretary.

The losses suffered by the two corporations in 1927 should have been allowed under this section unless the two returns filed for 1928 constituted two "taxable years" and we do not think they did.

Section 48 (a) of the Act provides:

> "Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. "Taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made. The first taxable year, to be called the taxable year 1928, shall be the calendar year 1928 or any fiscal year ending during the calendar year 1928.

The "taxable year" in question was the "calendar year" for 1928 and the calendar year "includes" the fractional part of the "taxable year" for which the return was made, but the "fractional part" is not the whole taxable year; it is simply included in the "taxable year."

To hold the petitioner to the government's abstraction would work an unusual hardship which is not the object of legislation unless specifically pointed out. The doubt cast upon the government's construction is sufficient in itself to resolve the question in favor of the petitioner. *Gould* v. *Gould*, 245 U. S. 151. The losses sustained in previous years should have been allowed in 1929.

The order of redetermination of the Board of Tax Appeals is modified, in accordance with this opinion.

OPINION

SUPREME COURT OF THE UNITED STATES.

No. 12.—October Term, 1934.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Morgans, Incorporated, et al.	On Writ of Certiorari to the United States Circuit Court of Appeals for the First Circuit.

[November 5, 1934.]

Mr. Justice Stone delivered the opinion of the Court.

This petition for certiorari, 292 U. S. 618, presents for determination the single question, whether the two separate periods in 1925, for which the taxpayer made separate income tax returns, constitute two "taxable years" within the meaning of § 206 of the Revenue Act of 1926, c. 27, 44 Stat. 9, 17, which permits the taxpayer suffering a net loss in any taxable year to deduct it from taxable gains in the two succeeding taxable years.

On June 1, 1925 respondent, Morgans, Incorporated, acquired all the voting stock of respondent Haines Furniture Company. Later, and in due course, in compliance with § 240 (a) and Article 634 of Treasury Regulations 69, the Haines Company filed its separate income tax return for the first five months of 1925 preceding the affiliation, and the two affiliated corporations filed a consolidated return for the last seven months of the year and for the calendar years 1926 and 1927. During the seven months' period of 1925, and in 1926 and 1927, Morgans, Incorporated reported net income. In the first five and the last seven months of 1925, and in 1926, the Haines Company suffered net losses. In 1927 it made a net profit. Its net loss in the first five months of 1925, before affiliation, was shown in its separate return for that period. Its net losses for the last seven months of 1925 and for the year 1926 were shown in the consolidated returns of the two corporations for those periods and were deducted from the net income of Morgans, Incorporated, in the returns for each of these periods. In the consolidated return for 1927, the Haines Company brought forward its loss for the first five months of 1925 and deducted it from its net income for 1927, under the provi-

sions of § 206 (b). The Commissioner disallowed this deduction, and determined a corresponding deficiency for the taxable year 1927. The order of the Board of Tax Appeals sustaining his action, — B. T. A. —, was set aside by the Court of Appeals for the first circuit. 68 F. (2d) 325. Like rulings have been made by the Courts of Appeals in other circuits. *Arnold Constable Corporation* v. *Commissioner of Internal Revenue,* 69 F. (2d) 788 (C. C. A. 2d); *Crossett Western Company* v. *Commissioner,* — F. (2d) — (C. C. A. 3rd); *Joseph & Feiss Co.* v. *Commissioner,* 70 F. (2d) 804 (C. C. A. 6th). A different conclusion was reached in *Wishnich-Tumpeer, Inc.* v. *Commissioner,* decided March 12, 1934, by the Court of Appeals of the District of Columbia, under the Revenue Act of 1928, applied in circumstances and under regulations not involved in the present case.

Section 206(b) permits the taxpayer to carry forward a net loss sustained "for any taxable year" and to deduct it from "net income of the taxpayer for the [redacted] succeeding taxable year." If the net loss to be deducted is in excess of the net income for that year, he is permitted to deduct the excess "from the net income of the next succeeding taxable year," referred to in the section as the "third year." In all cases the deduction is to be made under regulations made by the Commissioner.

It is plain that under this section the Haines Company, had it not taken advantage of the statutory provision authorizing consolidated returns, would have been permitted to carry over its net loss of 1925 for the next two succeeding years, and as it made no profit in 1926 its entire net loss for 1925 could have been deducted from its profit in 1927. But the government contends that the taxpayer has forfeited that privilege by making a return for the first five months of 1925, as it was required to do in order to avail itself of the privilege of making consolidated returns after the date of affiliation. It is said that the two periods in 1925, for which separate returns were made, are two separate taxable years within the meaning of the tax act, so that the "third year" within which § 206 permits the deduction is, in this case, the year 1926. This construction is required, it is urged, by the definition of "taxable year" in § 200 (a), which reads:

"(a) The term 'taxable year' means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or 232. The

term 'fiscal year' means an accounting period of twelve months ending on the last day of any month other than December. The term 'taxable year' includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made. The first taxable year, to be called the taxable year 1925, shall be the calendar year 1925 or any fiscal year ending during the calendar year 1925." (U. S. C., Title 26, Sec. 931.)

The provision that the term "taxable year" "includes" the period of less than twelve months for which a separate return is made, when read only with its immediate context, is not free from ambiguity. It may be admitted that the term "includes" may sometimes be taken as synonymous with "means", and that the subsection may be taken to require, as the Government contends, that a fractional part of a normal taxable year of twelve months for which a return is made shall be treated, for all purposes, as a separate taxable year.

But the phraseology is also open to the construction that the word "includes" is used as the equivalent of "comprehends" or "embraces," and that by it the section merely adopts a familiar device in aid of statutory construction, by providing that wherever other sections refer to a "taxable year" that phrase may, if the context requires, be taken also to refer to or to "include" a fractional part of that taxable year, for which a separate return is made.[1]

[1]The terms "means" and "includes" are not necessarily synonymous. The distinction in their use is aptly pointed by §§ 2, 200 of the Act itself. § 2 (a) gives general definitions of ten terms; of these, three are stated to "include" designated particular instances, the other seven are stated to "mean" the definitions subsequently given. § 200, in addition to the definitions contained in subsection (a), gives four of which two use the verb "include" and two the verb "means". That the draftsman used these words in a different sense seems clear. The natural distinction would be that where "means" is employed, the term and its definition are to be interchangeable equivalents, and that the verb "includes" imports a general class, some of whose particular instances are those specified in the definition. This view finds support in § 2 (b), which reads: "The terms 'includes' and 'including' when used in a definition contained in this Act shall not be deemed to exclude other things otherwise within the meaning of the term defined." This indicates that the particular is not necessarily a substitute for the general term, excluding more general meanings included within its scope. "Taxable year" is defined in § 200(a) as "meaning" a calendar or fiscal year of twelve months, and "in-

If the language is so construed and applied here, "the loss sustained for any taxable year," which § 206 permits to be carried forward, would include the loss sustained for the first five months of the taxable year for which the separate return was made, and that loss, as well as any other loss separately reported for the remaining part of the taxable year, not otherwise absorbed, could be carried forward to the taxpayer's next two succeeding taxable years, here the calendar years of 1926 and 1927. This construction finds support in the final sentence of the subsection which declares that the "first taxable year", which by definition "includes" a fractional part of the year, "shall be the calendar year 1925 or any fiscal year ending during the calendar year 1925." Obviously the first five months of 1925 could not be the calendar year 1925. But a return made for those months, a fractional part of the year, might be treated, within the meaning of the section, as a return for the calendar year of which they are a part. It plainly is not contemplated that the five months are to be treated as a taxable year different from the calendar year.

But the true meaning of a single section of a statute in a setting as complex as that of the revenue acts, however precise its language, cannot be ascertained if it be considered apart from related sections, or if the mind be isolated from the history of the income tax legislation of which it is an integral part. See *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 464. The revenue acts since the Sixteenth Amendment have consistently assessed income taxes on the basis of annual accounting periods, either the calendar year or the different fiscal year which the taxpayer may adopt. From the beginning these periods have been known as taxable years and the provisions of the taxing statutes have been drafted and enacted with primary reference to such normal accounting periods. *Burnett* v. *Sanford & Brookes Co.*, 282 U. S. 359, 363; *Woolford Realty Co., Inc.* v. *Rose*, 286 U. S. 319, 326. The statutes since 1917, and related regulations, have uniformly required the taxpayers' returns to be made on the basis of the twelve months' accounting period shown by the taxpayer's books, whether it be the calendar

cluding" a fractional part of a year; it hardly can be said that the words plainly and without ambiguity import that in § 206 (b) the term must be taken to mean only a fractional part of the year, to the exclusion of the alternative definitions of a calendar or fiscal year.

year or a different fiscal year. The change of this period by the taxpayer from the calendar to a different fiscal year or the reverse, has been permitted only on consent of the Commissioner and upon compliance with appropriate regulations. These dominating features of income tax legislation were incorporated in the 1926 Act by §§ 212, 232, to which § 200 (a) expressly refers.

The definition of "taxable year" in § 200 (a) is therefore incomplete unless it be understood that the period for which a return is made, whether it be for a year or a fractional part of it, is to be related to the twelve months' accounting period of the taxpayer. Where the return is for a period of less than twelve months, the year of which it is a fractional part is the annual accounting period of the taxpayer, which is his taxable year. Here the taxpayers' taxable year, both before and after the year of affiliation, was the calendar year. After affiliation, as before, the affiliated corporations, although filing consolidated returns, continued to be separate taxable units. The consolidated returns operated only to unite them for the purpose of tax computation and the equitable apportionment between them of the tax thus computed. See *Woolford Realty Co., Inc.* v. *Rose, supra,* 328. During 1925, the year of affiliation, the accounting year of the taxpayers remained the calendar year and was their taxable year in the sense that it was the twelve months' accounting period for which they were bound to report income and pay taxes, although permitted to make separate returns for fractional parts of the year in order that the income for the seven months following affiliation might be reported in a consolidated return. The filing of separate returns for fractional parts of the year did not involve any change of the taxpayer's accounting year, and had no effect upon the actual net income of the taxpayer for that year, or on the amount of tax payable except insofar as the provisions for a consolidated return were availed of.

Section 206 (b) appeared in the revenue acts prior to the addition, in § 200 (b), of the provision that the term taxable year includes fractions of a year. See §§ 204 (b) of the Revenue Acts of 1918, c. 18, 40 Stat. 1057, 1061, and 1921, c. 136, 42 Stat. 227, 231. In the 1921 Act it allowed to the taxpayer entitled to its benefits two full accounting periods of twelve months each within which he might carry over and deduct losses of an earlier taxable period.

In view of the extent to which the practice of fixing the tax with reference to the twelve months' accounting periods of the taxpayer has been recognized and carried into the structure of the revenue acts, only clear and compelling language added to § 200 (a) to define the phrase "taxable year" would justify application of that phrase in the remedial section 206 to periods of less than twelve months, in such manner as to restrict the benefits which like sections had previously extended to taxpayers entitled to enjoy them.

It is no answer to the arguments of respondent to say, as the Government does, that the meaning of the phrase "taxable year" must be the same throughout the section. The same meaning need not always be attributed to a phrase which, by hypothesis, has more than one meaning for purposes of statutory construction. By the Government's own construction, taxable year as used in § 206 is taken to mean the first five months of 1925, the last seven months of that year, and the entire calendar year 1926. The question which we have to decide is whether the two taxable years, within which the taxpayer is permitted to deduct his loss are to be taken as the two taxable years of the taxpayer, here the calendar years 1926 and 1927, even though the statute includes in the loss to be deducted that incurred in the first five months of the calendar year 1925.

The provision of § 200 (a), that the term taxable year includes fractions of a year for which a return is required, first appeared in the like section 200 (a) of the Revenue Act of 1924, c. 234, 43 Stat. 253, 254. The corresponding sections 200 of the 1918 and the 1921 Acts made no reference to fractions of a year for which a return is made. They defined the taxable year as the twelve months of the calendar year or of the fiscal year on the basis of which the net income was computed, although §§ 226, 240 of each act and related regulations provided in special circumstances for returns for a fractional part of a year. Before the 1924 Act the Commissioner had ruled that a fractional part of a taxable year for which a tax return was made was not a taxable year, and that in consequence the privilege granted to taxpayers by § 204 (b) of those acts of carrying over a loss sustained "for any taxable year" to the next or the two succeeding taxable years did not extend to losses shown by a return for a fraction of a year. This ruling was sustained by numerous decisions of the Board

of Tax Appeals. See *Takoma Grocery Company* v. *Commissioner,* 1 B. T. A. 1062; *Arthur Walker & Co.* v. *Commissioner,* 4 B. T. A. 151; *Dorsey Drug Co.* v. *Commissioner,* 7 B. T. A. 229; *Turners Falls Power & Electric Co.* v. *Commissioner,* 9 B. T. A. 435; *General Box Corp.* v. *Commissioner,* 22 B. T. A. 725, 729. The House Ways and Means Committee, in reporting the bill which became the Revenue Act of 1924 explained the amendment to § 200 as follows: "In subdivision (a) of this section the term 'taxable year' is defined to include a period of less than a year when a return is made for such period. Under the existing law the use of the term 'taxable year' in the 'net loss' section and other sections has been construed not to cover the case of a return made by a taxpayer for a fractional part of a year, with the result that the benefits of such section are denied to taxpayers who are required by law to make a return for a fractional part of a year." Report 179, Ways and Means Committee, 68th Cong., 1st Sess., p. 10. The report of the Senate Finance Committee uses identical language. Report 398, Finance Committee, 68th Cong., 1st Sess., p. 10.

The 1918 Act had permitted the carrying over of the loss for a single taxable year. The 1921 Act had extended the privilege for a period of two full years. There is no suggestion in the committee reports that by the 1924 amendment of § 200, in order to extend the benefits, conferred by § 204 in earlier acts, to the taxpayer who makes a return for a fractional part of his taxable year, there was the purpose to withhold from him any of these benefits. The implication is clear that there was not, and that the intention was that a taxpayer filing a return for a part of his taxable year should stand on the same footing, with respect to carrying over a loss shown by his return, as the taxpayer who had filed a return for the entire twelve months of the same taxable year. This intention was made effective by the addition to § 200 of words which, in terms, made the phrase "taxable year" as used in § 206 include "in the case of a return for a fractional part of a year," that part of the taxable year for which the return is made. Thus, under § 206 the loss for a taxable year which may be carried over includes the loss for the fractional part of the taxable year of the taxpayer, for which a separate return is required. The next succeeding taxable years to which the loss may be carried are likewise the taxable years of the taxpayer, here the calendar years 1926 and 1927.

It is of some significance that Article 634 of Treasury Regulations 69, which in case a consolidated return is made requires a separate return for the fractional part of a year not included in the consolidated return, uses the phrase "taxable year" as referring to the taxable year of the taxpayer, and speaks of the fraction of a year for which a separate return is made as "the portion of the taxable year" during which the taxpayers were not affiliated. It does not refer to the return as the return for a taxable year, but only as a return for a fractional part of the taxable year and such returns are required to be made and the tax is required to be paid at the same time as in the case of a return for the entire taxable year.

It is unnecessary to consider the effect to be given to returns required for a fractional part of the year, where the taxpayer changes his taxable year from a calendar year to a different fiscal year, or vice versa, with respect to which different considerations may enter. See *Wishnich-Tumpeer, Inc.* v. *Commissioner, supra.*

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.